

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200921027**
Release Date: 5/22/2009

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:

Index Number: 1362.04-00

, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-149695-08
Date:
February 06, 2009

Legend

Company =

Shareholder1 =

Shareholder2 =

Individual =

Date1 =

State =

Dear :

This letter responds to a letter dated November 17, 2008, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

Company was incorporated under the laws of State on Date1. Company elected to be treated as an S corporation effective Date1. Upon incorporation, Company had two shareholders: Shareholder1 and Shareholder2. Shareholder1 is a corporation that elected to be treated as an S corporation, and thus is not an eligible S corporation shareholder under § 1361(b)(1)(B). Upon discovery of the ineffective S corporation

election, Shareholder1's shares in Company were distributed to Individual, Shareholder1's sole shareholder.

Company represents that Company and its shareholders have at all times intended Company to be an S corporation, and have treated Company consistent with this intent. Company also represents that Company and its shareholders have reported their income consistent with Company being an S corporation. Company represents that, other than the ineligibility of Shareholder1 to be a shareholder of Company, Company has met the definition of an S corporation under § 1361(a)(1). Company and all of its shareholders consent and agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary under § 1362(f).

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such ineffective period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based on the information submitted and representations made, we conclude that Company's S corporation election was ineffective because Shareholder1 was an ineligible S corporation shareholder under § 1361(b)(1). We further conclude that the invalid election was inadvertent within the meaning of § 1362(f).

Under § 1362(f), Company will be treated as if it were an S corporation from Date1 and thereafter, provided that Individual is treated as being the owner of Shareholder1's stock in Company from Date1 and thereafter. Accordingly, Company's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately and non-separately computed items of Company as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by Company as provided by § 1368. If Company or any of the shareholders fail to treat Company as described above, this ruling shall be void.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning whether, Company otherwise qualifies as an S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: